



DR BEYERS NAUDE LOCAL MUNICIPALITY

Audit Report

For the year ended 30 June 2019



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Report of the auditor-general to Eastern Cape Provincial Legislature and the council on the Dr Beyers Naude Local Municipality

Report on the audit of the financial statements

Disclaimer of opinion

1. I was engaged to audit the financial statements of the Dr Beyers Naude Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the financial statements of the municipality. Due to the significance of the matter described in the basis for disclaimer of opinion section of my report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

Employee related costs

3. The municipality incorrectly calculated employee costs when compared to the signed employment contracts. This resulted in discrepancies between the annual salaries per the payroll and the annual salaries reflected in the employment contracts. Consequently, this resulted in employee related costs in note 30 and payables from exchange transactions in note 14 being understated by a R107,4 million for the 2018-19 financial year. This also has an impact on accumulated surplus for the year.
4. I was unable to obtain sufficient appropriate audit evidence for employee related costs due to the poor status of the accounting recordings relating to the back pay that was paid for salary equalisation. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to employee related costs stated at R159,3 million (2017-18: R138,1 million) in the financial statements.

Payables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for the balance of trade payables and other accruals due to insufficient information being submitted for audit purposes. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to trade payables and other accruals stated at R174,2 million (2017-18: R121,9 million) in the financial statements.

Expenditure

6. I was unable to obtain sufficient appropriate audit evidence for the balance of bulk purchases because the municipality did not have a control in place to assess whether the number of units that are being billed by Eskom are valid. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to bulk purchases stated at R89,2 million (2017-18: R81,2 million) in the financial statements.
7. The municipality did not classify expenditure within the different expense categories in general expenditure in accordance with GRAP 1 – *Presentation of financial statements*. Consequently general expenses disclosed in note 37 of the financial statements was misstated. It was impracticable to determine the value of the misclassification due to the magnitude of the errors identified. Consequently, I was unable to determine whether any adjustment was necessary to general expenses stated at R62,3 million (2017-18: R85,2 million) in the financial statements.
8. I was unable to obtain sufficient appropriate audit evidence that finance costs had been properly accounted for, as the information used by the expert to perform the calculation of the employee benefit obligation was incorrect. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to finance costs stated at R6,9 million (2017-18: R7,2 million) in the financial statements.

Irregular expenditure

9. The municipality did not adequately investigate the irregular expenditure written off in the notes of the financial statements, as required by section 32(2)(b) of the MFMA. This was because the municipality did not implement the recommendations of the municipal public account committee (MPAC) before writing it off. Consequently, irregular expenditure as disclosed in note 46 was understated by R79 million.

Employee benefit obligation

10. I was unable to obtain sufficient appropriate audit evidence regarding the balance of employee benefit obligation because the information used by the expert to perform the calculation was incorrect. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to employee benefit obligation stated at R60,3 million (2017-18: R46,2 million) in the financial statements.

Investment property

11. I was unable to obtain sufficient appropriate audit evidence regarding the balance of investment property because I could not rely on the valuation performed by the valuer as it could not be confirmed that the valuer was registered at the time of performing the valuations. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to investment property stated at R67,8 million (2017-18 R67,8 million) in the financial statements.

Unspent Conditional Grants

12. The municipality reported unspent conditional grants in terms of GRAP 23, however this was not supported by the bank balance at year-end. Consequently, unspent conditional grants was overstated by R22,1 million and payables from exchange transactions was understated by the same amount.

Unauthorised expenditure

13. The municipality incorrectly calculated unauthorised expenditure in the current year by not including the spending of R22,1 million which was money appropriated for drought relief, but used for other purposes. Consequently, unauthorised expenditure as stated in note 44 to the financial statements was understated by R22,1 million.

Receivables from exchange transactions

14. I was unable to obtain sufficient appropriate audit evidence regarding the balance of receivables from exchange transactions because I could not inspect the indigent debtors' application forms to determine whether they qualified to be categorised as indigent debtors. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to receivables from exchange transactions stated at R16,2 million in the financial statements.

Value added tax (VAT) receivable

15. I was unable to obtain sufficient appropriate audit evidence regarding the balance of VAT receivable because the municipality did not have a control in place to assess whether the number of units billed by Eskom were valid. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to VAT receivable stated at R13,6 million (2017-18: R1,2 million) in the financial statements.

Heritage assets

16. I was unable to obtain sufficient appropriate audit evidence regarding the balance of heritage assets as I could not rely on the valuation performed by the valuer due to a lack of evidence to confirm that he was registered at the time of performing the valuations. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to heritage assets stated at R13,5 million (2017-18: R13,5 million) in the financial statements.

Distribution losses – electricity

17. I was unable to obtain sufficient appropriate audit evidence regarding the balance of distribution losses – electricity because the municipality did not have a control in place to assess whether the number of units billed by Eskom were valid. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to distribution losses – electricity stated at R12,2 million (2017-18: R25,2 million) in note 51 to the financial statements.

Actuarial (loss)/gain and release from obligation

18. I was unable to obtain sufficient appropriate audit evidence regarding the balance of actuarial (loss)/gain and release from obligation had been properly accounted for, as the information used by the expert to perform the calculation of the employee benefit obligation was incorrect. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to actuarial (loss)/gain and release from obligation stated at R8,6 million(2017-18: (R3.5 million) in the financial statements.

Distribution losses – Water

19. I was unable to obtain sufficient appropriate audit evidence regarding the balance of distribution losses – water because the municipality had no control in place to assess whether the number of units billed by Eskom are valid, furthermore due to the qualification on employee costs I could not confirm the validity of the inputs for the calculations. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to distribution losses – water stated at R8,5 million in note 52 to the financial statements.

Cash flow statement

20. The municipality incorrectly classified and incorrectly calculated various line items in the cash flow statement. This resulted in the following line items being misstated as described:

- Cash receipts from customers understated by R49,2 million (2017-18: R25,8 million)
- Cash paid to suppliers and employees understated by R49,8 million (2017-18: R21,2 million)

Preparation of the financial statements

21. I was unable to obtain sufficient appropriate audit evidence that the accounting officer has fulfilled his responsibility for the preparation and fair presentation of the financial statements in accordance with the GRAP reporting framework, as written representations in this respect were not provided. I was also unable to obtain written representations from the accounting officer that I had been provided with all relevant information and access as agreed in terms of the audit engagement, and that all transactions had been recorded and were reflected in the financial statements. I could not determine the effect of the lack of such representations on the financial position of the municipality at 30 June 2019 or the financial performance and cash flows for the year then ended.

Context for the opinion

22. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.

23. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and, parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.

24. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my disclaimed opinion.

Emphasis of matter

25. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Fruitless and wasteful expenditure

26. As disclosed in note 45 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R16,2 million (2018: R8,4 million) during the current year.

Debt impairment

27. As disclosed in note 32 to the financial statements, debt impairments of R31,9 million (2018: R8,7 million) were made to receivables from exchange and non-exchange transactions respectively.

Other matters

28. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

29. In terms of section 125(2)(e) of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Unaudited supplementary information

30. The supplementary information set out on pages x to x does not form part of the annual financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Responsibilities of accounting officer for the financial statements

31. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the MFMA and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (Dora), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

32. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

33. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
34. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

35. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
36. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
37. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2019:

Development priorities	Pages in the annual performance report
KPA 2: Basic Service Delivery and Infrastructure Development	x – x

38. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

39. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

KPA 2: Basic Service Delivery and Infrastructure Development

Various indicators

40. The municipality did not have an adequate record keeping system to enable reliable reporting on achievement of the indicators listed below. As a result, I was unable to obtain sufficient appropriate audit evidence in some instances, while in other cases the supporting evidence provided did not agree to the reported achievements. Based on the supporting evidence that was provided, the achievement of these indicators was different to the reported achievement in the annual performance. Consequently, I was unable to determine whether any adjustments were required to the reported achievements in the annual performance report for the indicators listed below:

No	Performance indicator	Reported achievement
1.	Replacement of Bulk electricity consumer meters in Aberdeen to reduce water electricity losses by 30th June 2019.	67 meters replaced in Aberdeen.
2.	Number of boreholes equipped/Refurbished in Willomore by 30 th June 2019	4 boreholes has been refurbished
3.	Number of households to be connected with water services by 30th June 2019.	72 households connected with water services. Certified by NHBRC
4.	Number of households to be connected with Sanitation services by 30 th June 2019	72 households connected with water services Certified by NHBRC

41. The municipality did not have proper review and validation processes in place to ensure that all the planned indicators per the SDBIP are transferred consistently to the annual performance report. As a result, the reported annual achievement for the “Number of households to be connected with sanitation services by 30th June 2019” is not consistent with the planned target per the revised SDBIP.

Other matters

42. I draw attention to the matters below.

Achievement of planned targets

43. Refer to the annual performance report on pages x to x; x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the disclaimer of opinion expressed on the usefulness and reliability of the reported performance information in paragraphs 40 to 41 of this report.

Adjustment of material misstatements

44. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 2: Basic Service delivery and Infrastructure Development. As management subsequently corrected only

some of the misstatements, we raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are included in the basis for qualified opinion paragraphs.

Report on the audit of compliance with legislation

Introduction and scope

45. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality] with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
46. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements and annual report

47. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.
48. The council failed to adopt an oversight report containing the council's comments on the annual report (within the prescribed timelines), as required by section 129(1) of the MFMA.

Expenditure management

49. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
50. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph.
51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R16,2 million, as disclosed in note 45 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.
52. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the unauthorised expenditure incurred as indicated in the basis for qualification paragraph.

Revenue management

53. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.

Conditional grants

54. I was unable to obtain sufficient appropriate audit evidence that the Drought Relief Grant was spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of the Division of Revenue Act (Act 1 of 2018).

Liability management

55. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

56. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.

57. I was unable to obtain sufficient appropriate audit evidence that losses resulting from unauthorised expenditure were recovered from the liable person, as required by section 32(2)(a) of the MFMA. This was due to proper and complete records that were not maintained as evidence to support the investigations into unauthorised expenditure.

58. Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

59. I was unable to obtain sufficient appropriate audit evidence that losses resulting from irregular expenditure were recovered from the liable person, as required by section 32(2) of the MFMA. This was due to proper and complete records that were not maintained as evidence to support the investigations into irregular expenditure.

60. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

61. I was unable to obtain sufficient appropriate audit evidence that losses resulting from fruitless and wasteful expenditure were recovered from the liable person, as required by section 32(2) of the MFMA. This was due to proper and complete records that were not maintained as evidence to support the investigations into fruitless and wasteful expenditure.

Procurement and contract management

62. Bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by the Preferential Procurement Regulations 8(2) of 2017.

63. Some of the commodities designated for local content and production, were procured from suppliers who did not submit a declaration on local production and content as required by the preferential procurement regulation 8(5) of 2017.

64. Sufficient appropriate audit evidence could not be obtained that commodities designated for local content and production, were procured from suppliers who submitted a declaration on local production and content as required by the 2017 preferential procurement regulation. Similar limitation was also reported in the prior year.

65. Sufficient appropriate audit evidence could not be obtained that commodities designated for local content and production, were procured from suppliers who met the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5).

66. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.

Other information

67. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, the audit committee's report, mayor's foreword and executive summary, municipal manager overview. The other information does not include the financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.

68. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

69. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

70. As a result of the disclaimer of opinion expressed on the financial statements, I do not conclude on material misstatements of the other information relating to the financial statements. If, based on the work I have performed relating to the audit of performance information and compliance with legislation, I conclude that there is a material misstatement of this other information, I am required to report that fact.

Internal control deficiencies

71. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the performance report and the findings on compliance with legislation included in this report.

72. Leadership did not exercise oversight over financial, performance and compliance reporting, as the annual financial statements, annual report and compliance reporting were not adequately reviewed, which contributed to the material findings reported.

73. The municipality did not maintain a proper record management system for records, or for the timely retrieval thereof, as evidenced by limitations experienced during the audit.

74. The internal audit unit lacked the capacity required to effectively perform their duties. Furthermore, management did not follow up the implementation of internal and external audit recommendations to address internal control deficiencies.

Auditor General
East London

30 November 2019



Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Dr Beyers Naude Local municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation
 - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may

reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.